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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973.

No. 73-1276

THE TROXEL MANUFACTURING COMPANY
Petitioner,

vs.

SCHWINN BICYCLE COMPANY
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

WILLIAM E. LUCAS
230 West Monroe Street
Chicago, Illinois 60606

WALTER P. ARMSTRONG, JR.
Commerce Title Building
Memphis, Tennessee 38103
Attorneys for Respondent

Of Counsel:
MALCOLM MCCALEB
MALCOLM MCCALEB, JR.
230 West Monroe Street
Chicago, Illinois 60606

Gunthorp-Warren Printing Company, Chicago • 346-1717

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THE QUESTIONS PRESENTED

1. Is a patent licensee which steadfastly holds to the benefits of its license agreement, while its licensor and an unrelated third party litigate the validity of the licensed patent, legally obligated to pay royalties up to the date of a final judgment invalidating the licensed patent?

2. Is a patent licensee legally entitled to recoup all royalties *actually paid* to its licensor when the licensed patent is adjudged invalid in litigation between the licensor and an unrelated third party?

ARGUMENT IN OPPOSITION TO GRANTING THE WRIT

I.

There Is No Conflict Between the Decisions of the Sixth Circuit in This Case and Lear v. Adkins.

In *Lear* v. *Adkins*, 395 U. S. 653, this Court exhaustively examined and ultimately overruled the doctrine of licensee estoppel. Estoppel had historically "muzzled" patent licensees, "often . . . the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery" (*Lear*, 395 U. S., at 670). In its opinion this Court consciously balanced the public interest in eliminating specious patents against this technical requirement of contract doctrine. Estoppel was abolished because it came out on the light end of the balance.

Petitioner Troxel's position, though nominally based on *Lear* v. *Adkins*, has nothing whatsoever to do with licensee estoppel. The decisions of the Sixth Circuit below follow and are expressly based upon *Drackett* v. *Chamberlain*, 63 F. 2d 853, 17 U. S. P. Q. 114 (1933), which case was cited by this Court in *Lear* v. *Adkins* as standing for the general rule that "licensees may avoid further royalty payments, regardless of the provisions of their contract, once a third party proves that the patent is invalid" (395 U. S., at 667). Petitioner ignores this general rule, and instead contends that *Lear* stands for the directly contrary rule that licensees may recoup all royalties paid under their licenses once a third party proves that the patent is invalid. Respondent contends that there is not a shred of support for such a rule in *Lear*.

That Petitioner seeks a wholly unwarranted extension of *Lear* was recognized and clearly stated by the Sixth Circuit in its initial opinion, at 465 F. 2d 1260 (Pet. App. B, p. 18a) as follows:

> "The public interest is protected adequately under *Lear* without imposing on the patent holder the obligation to

refund royalties paid under the license of a patent procured and asserted in good faith. A licensee may at any time cease royalty payments, secure in the knowledge that the invalidity of the patent may be urged when the licensor sues for unpaid royalties. *Lear, supra.* If the patent is declared invalid through the efforts and expenditures of another, no further royalties are due under the license agreement. *Drackett Chem. Co.* v. *Chamberlain Co., supra,* 63 F. 2d 853. Further, if the evicted licensee is sued as an infringer, the prior adjudication of invalidity enables the licensee to secure pretrial judgment in his favor. *Blonder-Tongue, supra,* 402 U. S. 313. To permit a licensee in addition to recoup royalties paid is to extend *Lear* far beyond its rationale. Congress has not seen fit to create an implied warranty of validity in license agreements. We decline to do so by judicial action."

II.

There Is No Conflict Between the Rationale or Public Policy of Lear and the Opinions Below.

It was a principal object of *Lear* to promote "the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain" (395 U. S., at 670). To this end, a licensee that ceases royalty payments (i.e., repudiates its license) and tests validity of the licensed patent in litigation with the licensor is freed of the royalty obligation from the date of repudiation, assuming the licensee prevails.

Neither this public policy nor the specific means chosen by this Court for its implementation is involved in *Troxel.* Troxel never litigated the validity of Schwinn's patent. Troxel simply sought the protection of a license and paid the royalties. Even after a third party had successfully attacked Schwinn's patent in a District Court, Troxel was unwilling to repudiate its license. Troxel doggedly maintained its stance beneath the umbrella of protection of the license, paid its royalties, and awaited the final outcome of litigation between its licensor and another, and

when it was over claimed that there had been a failure of consideration from the inception of the license and initiated suit for recovery of all the royalties it had paid. Petitioner stands in the position of an opportunist seeking a windfall from the efforts of a third party which successfully challenged Schwinn's patent. Troxel did nothing to further the Federal policy of testing ideas to determine if they are in the public domain.

No policy announced in *Lear* would dictate the revolutionary rule sought by Petitioner. On the contrary, such a rule would significantly frustrate the public policies promoted in *Lear*. Whereas *Lear* encourages early challenges by licensees of questionable patents, Petitioner's position would encourage delay, affording licensees an incentive *not* to contest validity. Licensees would avoid costly litigation and wait for someone else to challenge their licensors' patents. The licensee would have nothing to lose by waiting, but the public, in the meantime, would suffer. Questionable patents would stand unchallenged, and wait-and-see licensees would simply pass their royalty expenses on to the public. This point was lucidly summarized by the Sixth Circuit in its first opinion below, at 465 F. 2d 1253, 1260 (Pet. App. B, p. 17a):

> "We hold that neither equity nor public policy require that Troxel be permitted to recover the royalties it paid to Schwinn. Before entering into the licensing agreement Troxel was provided with a copy of the Schwinn patent and had access to the file history of the prosecution of that patent before the Patent Office. Troxel could have challenged the patent initially instead of taking a license. It could have done so at any time after the license agreement was executed. It failed to take this action. It waited for someone else to challenge the patent. Even after another litigant had undertaken the challenge and had been successful at District Court level, Troxel did not join in that challenge but instead elected to remain a royalty-paying licensee. During all this time it had the benefit of freedom from suit for infringement and agreement of Schwinn to attempt to halt unlicensed infringers. It also enjoyed freedom from liability for past infringement."

III.

There Is No Conflict or Inconsistency Between the Award of Schwinn's Counterclaim Below and the Holding and Doctrine of Lear.

Petitioner claims the Court below "reverted" to *Drackett* in awarding Schwinn's counterclaim. On the contrary, The Sixth Circuit simply applied *Drackett*, the same law that it has consistently applied since 1933.

Drackett, as applied to the facts of the case at bar, was unaffected by this Court's *Lear* decision. *Drackett*, as stated in *Lear*, stands for the established rule that a licensee's royalty obligation ceases "once a third party proves that the [licensed] patent is invalid". 395 U. S. at 667. Petitioner concedes that Schwinn terminated its claim for royalties as of December 22, 1970, when the final judgment of invalidity of the licensed patent was entered in litigation betwen Schwinn and a third party (Petition, p. 4).

Respondent concedes that *if* Troxel had (a) repudiated its license agreement by refusing to pay further royalties, and (b) proven the invalidity of Schwinn's patent in court, it would have been free of the royalty obligation, under *Lear*, from the date of repudiation. But Troxel did neither. Therefore, Troxel never put itself in a position to rely upon *Lear*, which deals *solely* with the necessity of allowing, even encouraging, judicial challenges to validity of licensed patents by licensees. Where the licensed patent is challenged and defeated by a *third party* *Drackett* controls, as recognized by the Sixth Circuit's statements below:

> "It has been the established rule in this Circuit for nearly forty years that a final adjudication of invalidity of a licensed patent operates as an eviction from the license, terminating the licensee's obligation to continue making royalty payments after that date but giving no right to recoup royalties already paid. *See Drackett Chem. Co.* v.

Chamberlain Co., 63 F. 2d 853, 855 (6th Cir. 1933). In *Drackett* the patent was held invalid in a District Court decision which was not appealed. *See* 63 F. 2d at 854. Absent a showing that Schwinn prosecuted its appeal to the Ninth Circuit in bad faith, the eviction in this case occurred on the date of the decision of the Court of Appeals. *Cf. Scherr* v. *Difco Laboratories, Inc.*, 401 F. 2d 443, 445 (6th Cir. 1968)." Troxel I Opinion, 465 F. 2d, at 1255 (Pet. App. B, p. 8a).

* * * * *

"Troxel did not cease royalty payments prior to the Ninth Circuit's holding of invalidity. *Drackett* makes it clear that Troxel cannot avoid liability for royalties prior to this date. The court in *Drackett* stated:

> 'It is only when, by judicial decree or otherwise, it is published to the world that the monopoly is destroyed, that the licensee can claim a corresponding release from his obligation to pay royalties.' 63 F. 2d at 854.

"It was our intention in *Troxel I* that the District Court on remand would compute royalties due for products sold prior to the eviction and enter judgment for this amount against Troxel." Troxel II Opinion, ___ F. 2d ___, 180 U. S. P. Q. at 294 (Pet. App. C, p. 27a).

IV.

The Opinion Below Correctly Followed All Established Precedent in Refusing to Allow Troxel a Refund of Royalties Paid Subsequent to the Judgment of the District Court in California.

The Court below carefully considered Troxel's claim that under *Drackett* it was "evicted" from its license on January 8, 1969, when the District Court for the Northern District of California declared Schwinn's patent invalid as "obvious" in light of the precise prior art that had been considered by the Patent Office (R. 39). Absent fraud in the procurement* of a

* "There is not the slightest suggestion in this record of any wrongful conduct by Schwinn in the procurement of the Brilando patent." 465 F. 2d, at 1259, footnote 5 (Pet. App. B, p. 16a).

patent, or bad faith in the prosecution of an appeal** the Sixth Circuit held that there was no precedent in either equity or public policy that would entitle Troxel to repayment of any royalties it had paid to Schwinn (465 F.2d, at 1259-60; Pet. App. B, pp. 16a-17a).

As has been repeatedly emphasized herein, Petitioner could have refused to pay royalties at any time it became willing to assume the position of an infringer, secure in the knowledge that it could have asserted invalidity in defense of any claim by Schwinn. Petitioner steadfastly refused to forsake its license, clearly believing that the benefits and protection it was deriving were too substantial to jeopardize. Schwinn's appeal of the District Court decision was taken in good faith, and the outcome of that appeal was unpredictable, as witnessed by Troxel's decision to continue paying royalties rather than risk being sued for infringement should Schwinn have prevailed. Troxel had the option either to litigate the patent or to honor its royalty obligation. Having chosen the latter course and tendered payment, the transaction was closed between Troxel and Schwinn. It is an elementary and fundamental principle that voluntary payment of money made by reason of a misapprehension of legal rights arising under a contract, with knowledge of the facts, is not recoverable.

V.

There Is No Conflict Between the Sixth Circuit's Holdings Below and Beckman Instruments.

Contrary to Petitioner's characterization of the "holding" of *Beckman Instruments* (7 Cir. 1970), 433 F. 2d 55, there is no "total and irreconcilable" conflict between the decisions below and *Beckman*. The defendant in *Beckman* raised the

** "In *Troxel I* we held that, absent a bad faith appeal, the eviction occurred on December 22, 1970, the date of the Ninth Circuit's holding of invalidity. 465 F. 2d at 1255. There has been no showing that Schwinn prosecuted its appeal in that case in bad faith." ..... F. 2d ....., 180 U. S. P. Q., at 293 (Pet. App. C, p. 25a).

issue of estoppel by marking, a corollary of the estoppel doctrine abolished by *Lear*. *Beckman* simply and properly held that, under *Lear*, a licensee cannot, even if it has marked its goods with the number of its licensor's patent, be estopped to contest the validity of the licensed patent.

The *dictum* quoted out of context by Petitioner is simply a restatement by the Seventh Circuit of the obvious result dictated by *Lear*, given the specific facts common to both *Lear* and *Beckman* that (a) the licensee had affirmatively repudiated its license and ceased paying royalties before (b) actually litigating, head to head with the licensor, the validity of the licensed patent. Petitioner has either failed or refused to recognize that the undisputed absence of these crucial elements from the facts of the case at bar constitutes a fatal flaw in its theory.

The foregoing applies equally to Petitioner's claim that the decisions below are in conflict with *Painton & Company* v. *Bourns* (2 Cir. 1971), 442 F. 2d 216, *Horwitt* v. *Movado Watch Agency, Inc.* (S. D. N. Y. 1973), 364 F. Supp. 687 or *Crane Co.* v. *Aeroquip Corporation* (N. D. Ill. 1973), 356 F. Supp. 733. None of these cases held a licensee entitled to a refund of royalties or freed a licensee from its obligation to pay royalties that had accrued prior to a repudiation of the license by the licensee.

VI.

The Sixth Circuit's Opinions Below Have Been Approved and Consistently Followed in Subsequent Federal Decisions.

Conspicuously absent from the Petition is any mention of three recent cases which are completely in accord with the Sixth Circuit's decisions below. Two of these decisions specifically approve and follow the first *Troxel* decision of the Sixth Circuit.

The same Circuit which decided *Beckman* has more recently decided (November 16, 1973) *Ransburg Electro-Coating Corporation* v. *Spiller & Spiller, Inc.*, ... F. 2d ....., 180 U. S. P. Q. 112. The Seventh Circuit held:

> "Spiller counterclaimed for refunds of monies paid on the settlement contract, and on the license agreement. Since we have determined that Ransburg may enforce the settlement contract, it necessarily follows that Spiller's claim for refund of monies paid on the contract must fail. With respect to the license agreement the decision in Troxel Manufacturing Co. v. Schwinn Bicycle Co., 465 F. 2d 1253, 175 USPQ 65 (6th Cir. 1972), is dispositive, and we therefore hold that Spiller's claim for a refund on the license agreement should have been summarily denied."

In *Bahamas Paper Company, Ltd.* v. *Imperial Packaging Corporation* (S. D. N. Y., February 20, 1973), 177 U. S. P. Q. 440, 58 F. R. D. 355, the Court (per Judge Knapp) discussed and quoted with approval from the first appellate opinion below, and concluded, in complete accord with the Sixth Circuit, as follows:

> "It seems to me that the rule should be that the licensee is relieved of his obligation to pay royalties the moment he effectively repudiates the license agreement, thus forswearing its 'fruits' and exposing himself to the risks of injunction proceedings or other legal action by his licensor."

Finally, Respondent directs the Court's attention to *Kraly* v. *National Distillers & Chemical Corp.* (D. C. N. D. Ill., January 31, 1973) ..... F. Supp. .....; 177 U. S. P. Q. 364, wherein the Court (per Judge Will), without mentioning *Troxel*, and on considerably different facts than presented in the case at bar, applied the repudiation principal against a licensee and held that that a licensee is liable for all royalties accrued prior to an effective repudiation, even though the patent was adjudged invalid.

Based on the foregoing, it is clear that there is no conflict of authority to justify the granting of the Petition. The District Court's decision was wrong, and has been corrected. The Sixth Circuit's reasoned reversal has been accepted and followed.

CONCLUSION

This Court's *Lear* decision neither necessitates nor warrants further consideration by this Court of the revolutionary theory advanced by Petitioner. *Lear* and the Sixth Circuit's *Troxel* decisions are not in conflict. This conclusion is underscored by recent decisions which have considered both *Lear* and *Troxel* and reached the unanimous conclusion that a licensee must forsake the protection of its license and assert the invalidity of its licensor's patent in court in order to claim any benefit under this Court's pronouncements in *Lear*.

Respondent submits that the Petition for a Writ of Certiorari should be denied.

Respectfully,

WILLIAM E. LUCAS
230 West Monroe Street
Chicago, Illinois 60606

WALTER P. ARMSTRONG, JR.
Commerce Title Building
Memphis, Tennessee 38103
Attorneys for Respondent

Of Counsel:
MALCOLM MCCALEB
MALCOLM MCCALEB, JR.
230 West Monroe Street
Chicago, Illinois 60606
Of Counsel